

**IN THE
SUPREME COURT OF MISSOURI**

SC87811

ABB C-E NUCLEAR POWER, INC.,

Respondent,

v.

DIRECTOR OF REVENUE,

Appellant.

**On Petition for Review from the
Missouri Administrative Hearing Commission
Hon. Karen A. Winn, Commissioner**

SUBSTITUTE BRIEF OF RESPONDENT

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JURISDICTIONAL STATEMENT

The issue on appeal is whether certain deemed gain income for federal income tax purposes is “nonbusiness income” as that term is defined in Missouri’s Multistate Tax Compact, Section 32.200, art. IV.1(5), RSMo 2000.¹

The provisions of Section 32.200, art. IV, are revenue laws as that term is used in Art. V, section 3 of the Missouri Constitution. In particular, Section 32.200, art. IV.1(1) and (5) define the tax base upon which Missouri taxable income is determined for a multistate corporation for purposes of establishing income tax liability, if any.

The decision below, and the resolution of the appeal of that decision, turns on the construction of Section 32.200, art. IV.1(1) and (5):

(1) “Business income” means income arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations.

. . . .

(5) “Nonbusiness income” means all income other than business income.

¹ Unless indicated to the contrary, all references to “Section” are to the Missouri Revised Statutes.

The Administrative Hearing Commission (“Commission”) concluded that under its construction of the terms "business income" and "nonbusiness income," based on its analysis of existing case law and the substantial factual record in this case, the gains at issue were nonbusiness income subject to allocation and, under the facts of this case, not subject to tax in Missouri.

Appellant Director of Revenue (“Director”) asserted that the instant case involved the “application” rather than the “construction” of a revenue law, and that therefore jurisdiction was not properly with the Missouri Supreme Court. Thus, the Director originally filed a petition for review in the Court of Appeals, Western District, pursuant to Missouri Supreme Court Rule 100.02, and §§ 621.050 and 621.189, RSMo 2000. The Court of Appeals determined that it could not decide the issue without construing the statute (*see* Mo. Const. Art. V, § 3) and thus the Court of Appeals transferred the petition to this Court pursuant to Supreme Court Rule 83.02 because the resolution of this appeal involves the construction of a revenue law and thus exclusive appellate jurisdiction lies with this Court. Mo. Const. Art. V, §11.

PRELIMINARY STATEMENT

On April 28, 2000, ABB C-E Nuclear's then parent corporation, Asea Brown Boveri, Inc., which is not a Missouri taxpayer and not a party to these proceedings, sold all of ABB C-E Nuclear's stock to a third party. Viewed as a sale of stock, there is nothing for Missouri to tax -- the sale of the stock was by Asea Brown Boveri, Inc. and not by a party to these proceedings.

Although the *actual*, corporate law form and substance of the transaction involved a sale of ABB C-E Nuclear's stock, a joint election was made by Asea Brown Boveri, Inc. and the purchaser for *federal* income tax purposes pursuant to IRC Section 338(h)(10)² to treat the stock sale as a deemed sale of all of "Old ABB C-E Nuclear's" assets to "New ABB C-E Nuclear," followed by the deemed liquidation of Old ABB C-E Nuclear and the subsequent deemed distribution of the deemed sales proceeds to Old ABB C-E Nuclear's parent corporation (the "IRC Section 338(h)(10) *Deemed* Treatment"). Thus, any gain realized by Asea Brown Boveri, Inc. on the sale of ABB C-E Nuclear's stock was disregarded for federal income tax purposes and, instead, a gain from the deemed sale of all of ABB C-E Nuclear's assets to the unrelated person was reflected for federal tax purposes.

The reason ABB C-E Nuclear is referred to as "Old ABB C-E Nuclear" and "New ABB C-E Nuclear" is that, after the election, ABB C-E Nuclear is treated for federal tax purposes as a new corporation with a new owner and with none of its previous

² 26 U.S.C. § 338 (Respondent's Appendix A1-A6).

tax history. After the IRC Section 338(h)(10) election, New ABB C-E Nuclear “starts fresh” in that it does not inherit any of the earnings and profits or any of the net operating losses of Old ABB C-E Nuclear that existed prior to the election and it is no longer affiliated with Asea Brown Boveri, Inc. It is treated for federal income tax purposes as if the buyer had formed a new corporation and that corporation purchased all of the assets of Old ABB C-E Nuclear.

ABB C-E Nuclear, a Delaware corporation with its commercial domicile in Connecticut, conducted some business in Missouri and timely filed its separate Missouri Corporation Income Tax return for its year ended April 28, 2000. On that return, ABB C-E Nuclear reported the gain from the deemed sale of all of its assets pursuant to IRC Section 338(h)(10) as nonbusiness income and, therefore, not subject to Missouri tax (the deemed sale of the assets located in Missouri did not result in any gain). The Director’s agent disallowed the characterization of the gain from the deemed asset sale as nonbusiness income subject to allocation and recharacterized the gain as business income subject to apportionment.

This case involves whether ABB C-E Nuclear’s deemed gain from the Section 338(h)(10) election should be construed to be apportionable business income and subject to Missouri Corporation Income Tax or allocable nonbusiness income and not subject to Missouri Corporation Income Tax. It is respectfully submitted that, if the IRC Section 338(h)(10) *Deemed* Treatment of the transaction controls the outcome (*i.e.*, the deemed sale of assets followed by the deemed liquidation), then the resulting gain

constitutes nonbusiness income. While the Missouri courts have not addressed this issue, this is exactly the result reached by the courts of both Illinois and Pennsylvania.

American States Ins. Co. v. Hamer, 816 N.E.2d 659 (Ill. App. Ct. 2004), *appeal denied*, 829 N.E.2d 786 (Ill. 2005) (Respondent's Appendix A7-A14); *Canteen Corp. v. Pennsylvania*, 854 A.2d 440 (Pa. 2004), *aff'g* 818 A.2d 594 (Pa. Commw. 2003) (Respondent's Appendix A15-A22); *Osram Sylvania, Inc. v. Pennsylvania*, 863 A.2d 1140 (Pa. 2004), *aff'g* No. 310 F&R 1998 (Pa. Commw. Mar. 6, 2003) (Respondent's Appendix A23-A30).

If, instead, it is the *actual*, corporate law form and substance of the transaction that controls (*i.e.*, the sale of ABB C-E Nuclear's stock by Asea Brown Boveri, Inc.), then ABB C-E Nuclear has -- in substance -- not made a sale of any of its assets and thus has not made any transfer which can be subject to Missouri tax and, therefore, the gain should be excluded in determining ABB C-E Nuclear's Corporation Income Tax liability. If the stock sale is respected, the party recognizing the gain is ABB C-E Nuclear's then parent, a corporation that is not a party to these proceedings.

The Director, disregarding the cases of Missouri and its sister states, asserts that the gain constitutes business income not because the gain arises in the regular course of ABB C-E Nuclear's business but because it allegedly arises in the regular course of business of ABB C-E Nuclear's former affiliates. The Director is wrong. In determining whether income constitutes business income or nonbusiness income, it is the transactions and activities of the taxpayer (in this case ABB C-E Nuclear) that are relevant. Activities

of ABB C-E Nuclear's former affiliates are irrelevant. The statute, regulations and case law confirm that in determining whether income constitutes business income or nonbusiness income, what is relevant is the activities of the taxpayer -- in this case ABB C-E Nuclear.

Inasmuch as ABB C-E Nuclear was not in the business of selling all of its assets and distributing the proceeds to its parent corporation in a complete liquidation (which is what is deemed to occur), the gain at issue clearly could only constitute nonbusiness income.

STATEMENT OF FACTS

ABB C-E Nuclear agrees with the findings of fact found by the Commission and that the findings fairly and accurately set forth the relevant facts required for reaching a finding in this case. The relevant facts are summarized below.

ABB C-E Nuclear's Corporate Structure

During its year ended April 28, 2000, ABB C-E Nuclear, a Delaware corporation, had its principal place of business and commercial domicile in Windsor, Connecticut. (Affidavit of Julietta Guarino ("Aff.") ¶ 4.³) Prior to and on April 28, 2000, ABB C-E Nuclear was a wholly owned subsidiary of Asea Brown Boveri, Inc. Asea Brown Boveri, Inc., in turn, was a wholly owned subsidiary of ABB Holdings, Inc. From 1998 until April 28, 2000, ABB Holdings, Inc. was a wholly owned subsidiary of ABB Participations, LLC. (Aff. ¶¶ 14-16.)

The Business Operations Of ABB C-E Nuclear

ABB C-E Nuclear was engaged in the nuclear business in the United States. Its principal place of business and commercial domicile were in Windsor, Connecticut and it had facilities located in Newington, New Hampshire, Hematite, Missouri and Chattanooga, Tennessee as well as other locations in the United States. (Aff. ¶ 18.)

³ The Affidavit of Julietta Guarino sworn to on February 9, 2005, and the extensive exhibits attached thereto, is in the Administrative Record at Vol. I, p. 52 through Vol. IV, p. 738, the Affidavit of Julietta Guarino sworn to on March 23, 2005 ("2nd Aff.") is in the Administrative Record at Vol. IX, pp. 1628-30.

The Divestiture

In 1999, ABB Ltd. decided to divest itself of its nuclear business in order to focus its resources on its other businesses. (Aff. ¶ 20.)

On April 28, 2000, (1) BNFL Nuclear Services, Inc., an affiliate of British Nuclear Fuels plc, purchased all of the outstanding stock of ABB C-E Nuclear from Asea Brown Boveri, Inc. for \$250,000,000 (subject to adjustments), and (2) other affiliates of British Nuclear Fuels plc around the world purchased the remaining stock and assets of the nuclear business for approximately \$235,000,000. (Aff. ¶ 23.)

All of the proceeds from the April 28, 2000 sale of the stock of ABB C-E Nuclear were received by Asea Brown Boveri, Inc., the sole shareholder of ABB C-E Nuclear. (Aff. ¶ 26.) Thus, the proceeds were not received -- directly or indirectly -- by ABB C-E Nuclear. (Aff. ¶ 27.)

The Seller of ABB C-E Nuclear's Stock (Its Parent) Had No Connection With Missouri And The Stock Sale Was Not Connected With Missouri

Prior to and at the time of the April 28, 2000 sale of ABB C-E Nuclear's stock, Asea Brown Boveri, Inc. was a Delaware corporation that was headquartered and commercially domiciled in Norwalk, Connecticut. The corporation did not conduct any business in Missouri, did not have any operations in Missouri, did not have any employees in Missouri, did not have any property in Missouri nor otherwise conduct any activities in Missouri. Asea Brown Boveri, Inc. did not, and was not required to, file

Corporation Income Tax returns with or pay Corporation Income Taxes to Missouri.

(Aff. ¶ 30.)

In addition, the April 28, 2000 sale of ABB C-E Nuclear's stock was not negotiated in Missouri, did not close in Missouri nor otherwise involve any Missouri activity. (Aff. ¶ 28.)

**Pursuant to a Federal Tax Election, The Sale of ABB C-E Nuclear's Stock
Was Treated as a Deemed Sale of All of ABB C-E Nuclear's Assets Followed
By the Deemed Liquidation of ABB C-E Nuclear for Federal Tax Purposes**

For federal income tax purposes, ABB C-E Nuclear was included in the consolidated federal income tax return filed by ABB Participations, LLC through the time its stock was sold (*i.e.*, April 28, 2000). In connection with the April 28, 2000 sale of ABB C-E Nuclear's stock, an election was made in the consolidated federal income tax return of ABB Participations, LLC to treat the stock sale as a deemed sale of assets under IRC Section 338(h)(10). The election was made jointly by both the buyer and seller of the stock. (Administrative Record, Vol. IV, pp. 737-38.) Under this election, ABB C-E Nuclear, the "target," was deemed for federal income tax purposes: (1) to have sold all of its assets while a member of the ABB Participations, LLC selling consolidated group in a single transaction to a new corporation; (2) to have received the proceeds from the sale; and (3) to have distributed such proceeds in a complete liquidation to its pre-acquisition shareholder, Asea Brown Boveri, Inc. (Aff. ¶ 34.)

As a result of the IRC Section 338(h)(10) election, any gain on the sale of ABB C-E Nuclear's stock was disregarded for federal income tax purposes and, instead, a gain from the deemed sale of ABB C-E Nuclear's assets to the buyer, an unrelated person was reflected in the consolidated federal income tax return of ABB Participations, LLC and subsidiaries. (Aff. ¶ 35; IRC § 338(h)(10).) As of the day after the acquisition date (in the instant case, as of April 29, 2000), ABB C-E Nuclear is treated for federal income tax purposes as a new, unrelated corporation 100% owned by the buyer, an unrelated third party. (Aff. ¶ 35; IRC § 338(a)(2).) The benefit of this election is that the purchaser will receive a stepped up basis in the assets it has acquired.

However, the election merely creates a legal fiction for federal tax purposes. At no time prior to April 28, 2000 or as a result of the transaction at issue, did ABB C-E Nuclear ever actually sell or otherwise dispose of all of its assets in Missouri or elsewhere. (Aff. ¶ 36.)

Procedural History

ABB C-E Nuclear filed separate, rather than consolidated, tax returns for Missouri Corporation Income Tax purposes. For its year ended April 28, 2000, the corporation timely filed its separate Missouri Corporation Income Tax return and elected to allocate and apportion its income pursuant to the Multistate Tax Compact. (Complaint ¶ 15; Answer ¶ 15;⁴ Administrative Record, Vol. I, p. 63.) ABB C-E Nuclear reported as

⁴ The Complaint and Answer are in the Administrative Record at Vol. I, pp. 1-14 and 15-17, respectively.

nonbusiness income the gain from the deemed sale of all of its assets pursuant to IRC Section 338(h)(10). (Complaint ¶ 16; Answer ¶ 16; Aff. ¶ 5.)

ABB C-E Nuclear did not recognize a gain from the deemed asset sale on the real and tangible personal property that was located in Missouri because the fair market value of those assets was less than the corporation's basis in those assets. Consequently, ABB C-E Nuclear realized a loss on the sale of the real and tangible personal property that was located in Missouri. (2nd Aff. ¶ 7.)

The majority of the gain resulting from ABB C-E Nuclear's deemed sale of assets was from the sale of goodwill and a small portion of the gain was from the sale of real and tangible personal property located at the corporation's facilities located outside of Missouri. (2nd Aff. ¶ 8.)

ABB C-E Nuclear similarly reported the gain from the IRC Section 338(h)(10) deemed asset sale as nonbusiness income in each state in which it was subject to tax and which distinguished between business income and nonbusiness income. In those states in which ABB C-E Nuclear was subject to tax but which did not distinguish between business income and nonbusiness income, the corporation followed the laws of those jurisdictions in reporting the gain. (Aff. ¶ 6.)

On October 22, 2002, the Director issued a Missouri Corporation Income Tax Notice of Deficiency for the tax year ended April 28, 2000 (the "Notice of Deficiency"). (Complaint ¶ 17; Answer ¶ 17.) The liability asserted as due in the Notice of Deficiency is the result of the Director's recharacterization of the gain from the deemed sale of

ABB C-E Nuclear's assets from nonbusiness income to business income. (Aff. ¶ 10.)

ABB C-E Nuclear timely protested the Notice of Deficiency. (Complaint ¶18; Answer ¶ 18.)

On January 15, 2004, the Director issued a Final Decision to ABB C-E Nuclear for its tax year ended April 28, 2000. (Complaint ¶ 19; Answer ¶ 19.) ABB C-E Nuclear timely filed a Complaint challenging the Final Decision. (Aff. ¶ 13.)

The Administrative Hearing Commission issued its Order Granting Summary Judgment In Part on June 23, 2005. In its Order, the Commission found that the gain from ABB C-E Nuclear's deemed asset sale constituted nonbusiness income which is not apportionable by Missouri. Consequently, ABB C-E Nuclear was not liable for the Missouri income tax assessed by the Director.

The Commission allowed the parties to supplement the record with respect to whether ABB C-E Nuclear was entitled to the refund claimed on its Missouri Corporation Income Tax return for its year ended April 28, 2000. The parties subsequently filed a stipulation as to the numbers. The Commission issued an Order, dated July 19, 2005, providing that ABB C-E Nuclear is entitled to a refund of \$15,766 of tax, plus applicable interest.

POINT RELIED ON

The Commission did not err in concluding that ABB C-E Nuclear's deemed gain from an IRC Section 338(h)(10) election constituted allocable nonbusiness income for Missouri Corporation Income Tax purposes because, under Section 621.189, that decision is supported by competent and substantial evidence on the record, is authorized by law, and is entirely consistent with the reasonable expectations of the Missouri General Assembly, in that the gain did not constitute business income under Multistate Tax Compact, Section 32.200, Art. IV.1(1) inasmuch as the gain did not arise from a transaction or activity in the regular course of ABB C-E Nuclear's trade or business nor did the gain result from the acquisition, management, and disposition of property constituting integral parts of ABB C-E Nuclear's regular trade or business operations and, consequently, the gain constitutes nonbusiness income under Multistate Tax Compact, Section 32.200, Art. IV.1(5).

Section 32.200, Art. IV

Williams Cos. v. Director of Revenue, 799 S.W.2d 602 (Mo. banc 1990), *cert. denied*, 501 U.S. 1260 (1991), *overruled on other grounds by General Motors Corp. v. Director of Revenue*, 981 S.W.2d 561 (Mo. 1998)

American States Ins. Co. v. Hamer, 816 N.E.2d 659 (Ill. App. Ct. 2004), *appeal denied*, 829 N.E.2d 786 (Ill. 2005).

Canteen Corp. v. Pennsylvania, 854 A.2d 440 (Pa. 2004), *aff'g* 818 A.2d 594 (Pa. Commw. 2003).

Osram Sylvania, Inc. v. Pennsylvania, 863 A.2d 1140 (Pa. 2004), *aff'g* No. 310 F&R 1998 (Pa. Commw. Mar. 6, 2003).

STANDARD OF REVIEW

The decision of the Commission shall be upheld unless: (1) it is not authorized by law; (2) it is not supported by competent and substantial evidence based upon the whole record; (3) a mandatory procedural safeguard was violated; or (4) it is clearly contrary to the Legislature's reasonable expectations. Section 621.193, RSMo 2000; *Concord Publ'g House, Inc. v. Director of Revenue*, 916 S.W.2d 186 (Mo. banc 1996). This Court's review of the law is *de novo*. *Zip Mail Servs., Inc. v. Director of Revenue*, 16 S.W.3d 588, 590 (Mo. banc 2000).

ARGUMENT

The Commission did not err in concluding that ABB C-E Nuclear's deemed gain from an IRC Section 338(h)(10) election constituted allocable nonbusiness income for Missouri Corporation Income Tax purposes because, under Section 621.189, that decision is supported by competent and substantial evidence on the record, is authorized by law, and is entirely consistent with the reasonable expectations of the Missouri General Assembly, in that the gain did not constitute business income under Multistate Tax Compact, Section 32.200, Art. IV.1(1) inasmuch as the gain did not arise from a transaction or activity in the regular course of ABB C-E Nuclear's trade or business nor did the gain result from the acquisition, management, and disposition of property constituting integral parts of ABB C-E Nuclear's regular trade or business operations and, consequently, the gain constitutes nonbusiness income under Multistate Tax Compact, Section 32.200, Art. IV.1(5).

**I. The Commission's Decision Is Supported By Competent And Substantial
 Evidence Based Upon The Whole Record**

Contrary to the Director's allegations (*e.g.*, Br. at 6, 13, 37), there was substantial evidence submitted in this case for the Commission to have found that the gain from ABB C-E Nuclear's deemed sale of all of its assets followed by the corporation's deemed liquidation constituted nonbusiness income under the Multistate Tax Compact. The

record (which is over 1,650 pages in length), clearly supports all of the Commission's findings of fact and conclusions of law.

There was also substantial discovery in this case. The Director's discovery alone included the following: Interrogatories; Second Set Of Interrogatories; Third Set Of Interrogatories; Request to Produce Documents; and Second Request For Production Of Documents.

The Director's current assertion that there are insufficient facts in the record for the Commission to have rendered a decision as to whether the gain at issue constitutes business income or nonbusiness income is also inconsistent with her Cross Motion For Summary Determination below. Apparently the Director did not have an issue with the record when she filed her Cross Motion For Summary Determination. ABB C-E Nuclear is uncertain how the Director could have believed previously that there were sufficient facts in the record for the Commission to have determined that the gain at issue constituted business income (and thus filed her Cross Motion For Summary Determination) and now believe that there are insufficient facts to support the Commission's decision that the gain constitutes nonbusiness income.

The Director's arguments concerning the alleged paucity of facts in the record appear to be based more on the fact that the record does not support her position, not that the record itself is lacking. It is the Director's position that it is the activities not of ABB C-E Nuclear but, instead, of "ABB" (which the Director defines as all of the

companies underneath the ultimate parent, ABB Participants LLC “collectively”⁵) that is determinative of whether the gain at issue was earned in the regular course of the taxpayer’s business and thus more information regarding those companies’ activities needed to be included as part of the record. Specifically, the Director argues that more information was needed in regard to “ABB’s” “acquisition, consolidation, and (sometimes) sale of companies in a particular business segment.” Br. at 26. However, as discussed below, even if the record is lacking in this regard, which it is not,⁶ there would be no need for such information to be included in the record because the activities of all of those entities as a whole is not determinative of whether the gain at issue constitutes business income; instead it is the activities of only one entity, ABB C-E Nuclear (the taxpayer in the instant case) that must be examined.

In addition, the Director’s unsupported statement that the findings of the Commission “suggest that ABB Nuclear operated as a division of ABB,” Br. at 27, has no basis in law or fact. The Director cites to two findings by the Commission that she believes provide support for her position. Br. at 27-28. However, these findings only demonstrate that the ultimate parent holding company, ABB Ltd., had “affiliated entities”

⁵ Br. at 7.

⁶ See the Affidavit of Julietta Guarino sworn to on February 9, 2005, and the extensive exhibits attached thereto, in the Administrative Record at Vol. I, p. 52 through Vol. IV, p. 738, and the Affidavit of Julietta Guarino sworn to on March 23, 2005 (“2nd Aff.”) in the Administrative Record at Vol. IX, pp. 1628-30

that operated “distinct business segments.” These findings in no way indicate that the Commission found that the separate corporate existence of ABB C-E Nuclear should be ignored, and such a finding could not be made based on the facts. ABB C-E Nuclear was a separate corporate entity with its own employees and operations, and the Director cannot simply ignore the separate existence of ABB C-E Nuclear because she wishes to use the activities of other entities as a basis for determining whether the deemed sale of ABB C-E Nuclear’s assets produced business income.

In conclusion, there is nothing in the record that gives any weight to the Director's unsupported allegations in regard to the record (especially in light of the substantial discovery in this case by the Director) and to the findings of the Commission. Consequently, the Commission’s decision is supported by competent and substantial evidence based upon the whole record.

II. In Construing Whether Income Constitutes Business Income Or Nonbusiness Income, It Is The Transaction And Activities Of The Corporate Taxpayer, And Not Of A Family Of Corporations, That Is Relevant.

A corporation that does business both within and without Missouri has two alternatives for the allocation and apportionment to Missouri of a percentage of the corporation’s total income. The taxpayer has the option under Section 143.451.2 to use a single-factor formula based on the company’s sales. The corporation has the other option of using the Multistate Tax Compact formula under Section 32.200, *et seq.* ABB C-E Nuclear chose the Multistate Tax Compact to allocate and apportion its income.

The Multistate Tax Compact draws a distinction between apportionable and nonapportionable (or allocable) income. Specifically, the Multistate Tax Compact provides that a multistate corporation's net taxable income is divided into two classes: (1) business income, which is apportioned among the states according to a three-factor formula of property, payroll and sales; and (2) nonbusiness income, which is allocated to the state most closely associated with the generation of the income (generally the commercial domicile of the taxpayer). Section 32.200, Art. IV.

Section 32.200, Art. IV.1(1) defines "business income" as follows:

"Business income" means income arising from transactions and activity *in the regular course of the taxpayer's trade or business* and includes income from tangible and intangible property if the acquisition, management, *and* disposition of the property constitute integral parts of *the taxpayer's regular trade or business operations*.

(Emphasis added.) In contrast, "nonbusiness income" is defined as "all income other than business income." Section 32.200, Art. IV.1(5). These definitions are based on the Uniform Division of Income for Tax Purposes Act ("UDITPA").

The Director asserts throughout her brief that the gain at issue herein constitutes business income because the gain allegedly arises from the regular business activity not of ABB C-E Nuclear, but of the corporation's former affiliates. For example, the Director asserts that when interpreting the business income definition the "'business' is undertaken by ABB (either ABB Ltd. or some entities in the ABB Family)." Br. at 25.

As discussed above, the Director defined “ABB” as ABB C-E Nuclear and all of its affiliates prior to the sale and uses the term “ABB” to refer to all of “the companies collectively” that are underneath the ultimate parent ABB Participants LLC. Br. at 7.

The Director then complains that there is insufficient information regarding all of ABB C-E Nuclear’s former affiliates for the Commission to have determined whether the gain was part of the regular business operations of ABB C-E Nuclear’s corporate family. The Director states that there was insufficient information in the record to “support a holding that the sale of [ABB C-E Nuclear] was not in the regular course of ABB’s business – the question posed to the [Commission].” Br. at 26.

The Director is wrong. The Director’s novel theory for determining whether income constitutes business income or nonbusiness income is inconsistent with the Multistate Tax Compact, her own regulations as well as with the cases upon which she purportedly relies.

Section 32.200, Art. IV.1(1) provides that business income is “income arising from transactions and activity *in the regular course of the taxpayer’s* trade or business” and also includes “income . . . if the acquisition, management, *and* disposition of the property constitute integral parts of *the taxpayer’s regular trade or business operations.*” (Emphasis added.)

The Multistate Tax Compact does not define the term “taxpayer” as a family of corporations. Instead, it defines the term as “any corporation . . . acting as a business entity in more than one state.” Section 32.200, Art. II.3. In the instant case, therefore, it

is ABB C-E Nuclear which is the taxpayer, it is not ABB C-E Nuclear and all of its former affiliates.

The Director's regulations similarly look to a single corporate taxpayer and not to a taxpayer's entire corporate family in determining whether income constitutes business income or nonbusiness income. The quote of the Director's regulation contained in her brief demonstrates this to be so.

Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is business income or nonbusiness income is the identification of the transactions and activity which are the elements of a particular trade or business. In general all transactions and activities of *the taxpayer* which are dependent upon or contribute to the operations of *the taxpayer's* economic enterprise as a whole constitute *the taxpayer's* trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or business. 12 CSR 10-2.075(4).

Br. at 22-23 (emphasis added).

The Director's regulation then defines "taxpayer," consistent with the Multistate Tax Compact, as "any corporation . . . acting as a business entity in more than one (1) state." 12 CSR 10-2.075(7). The regulation does not define a taxpayer to include all

affiliates of the corporate taxpayer, which is exactly what the Director is advocating in the instant case. Thus, under the Director's own regulations, the taxpayer at issue here is ABB C-E Nuclear, not any of its former affiliates. Moreover, the Director does not have the authority to require ABB C-E Nuclear and its former affiliates to file on a combined or consolidated basis. Section 143.431.3 RSMo.

The Director incorrectly asserts that this Court in *Dow Chemical Co. v. Director of Revenue*, 787 S.W.2d 276 (Mo. banc 1990), “held that the ‘business income’ addressed in the Compact is the income of the entire corporate family.” Br. at 19. In reality, *Dow* held that the “source of income” test does not impinge on the three-factor apportionment formula of the Multistate Tax Compact and that certain deemed distributions under the federal income tax were also entitled to treatment as dividends for purposes of the Missouri income tax.

In ruling on the first issue, this Court noted that “[t]he Compact, however, takes into account the entire business income of *a multistate enterprise* to determine the income apportionable to Missouri for taxation.” *Dow*, 787 S.W.2d at 283 (emphasis added). Thus, the decision was not referring to a group of corporations but was referring to a single corporation that does business in multiple states. This is consistent with the footnote immediately following the sentence which provides the definition of “business income” under the Compact which consists of certain income of a “taxpayer” and not of an “entire corporate family.” *Id.* at 283 n.12.

The Director's reliance on *Williams Cos. v. Director of Revenue*, 799 S.W.2d 602 (Mo. banc 1990), *cert. denied*, 501 U.S. 1260 (1991), *overruled on other grounds by General Motors Corp. v. Director of Revenue*, 981 S.W.2d 561 (Mo. 1998), is similarly misplaced. One of the issues in *Williams* was whether interest income that a corporate taxpayer received from loans to its parent corporations was business income. It was stated in *Williams* that: "Business income includes, but is not limited to, income from 'integral parts' of a taxpayer's business, but that is not the *sine qua non* of business income under the Compact. Rather, the test is whether the income is '*income from a unitary business*.'" *Williams*, 788 S.W.2d at 606 (quoting *Dow*, 787 S.W.2d at 283, emphasis in *Dow*). Since there was a unitary business relationship between the taxpayer recipient and the parent company payors, *Williams* held that the income constituted business income.

Thus, in determining whether income constituted business income, this Court in *Williams* looked to the business of the taxpayer, not to the business of an entire family of corporations.

Williams also held that capital gain income received by another corporate taxpayer, Williams Pipeline Company, from its sale of preferred stock in a joint venture with a third party constituted business income. In so finding, this Court looked to whether Williams Pipeline Company's interest in the joint venture was a part of Williams Pipeline Company's unitary business. This Court did not consider any affiliated entities of Williams Pipeline Company in rendering its decision. 799 S.W.2d at 606-07.

As the foregoing establishes, the Director's theory of looking to an entire corporate family for determining whether income constitutes business income or nonbusiness income is not supported by the decisions upon which she relies. Moreover, her theory is inconsistent with the Multistate Tax Compact and her regulations which both look to the taxpayer – in this case, ABB C-E Nuclear. Furthermore, unlike the *Williams* case, there is absolutely no unitary connection between ABB C-E Nuclear and the buyer of its stock.

Therefore, as is discussed in more detail below, if the transaction which produced the gain at issue herein is analyzed in accordance with the IRC Section 338(h)(10) *Deemed* Treatment, the resulting gain constitutes nonbusiness income. ABB C-E Nuclear was not in the business of selling all of its assets and then liquidating and distributing all of the sales proceeds to its parent corporation (which is what is deemed to have occurred under the IRC Section 338(h)(10) *Deemed* Treatment). *See, e.g., American States Ins. Co. v. Hamer*, 816 N.E.2d 659 (Ill. App. Ct. 2004), *appeal denied*, 829 N.E.2d 786 (Ill. 2005) (Respondent's Appendix A7-A14); *Canteen Corp. v. Pennsylvania*, 854 A.2d 440 (Pa. 2004), *aff'g* 818 A.2d 594 (Pa. Commw. 2003) (Respondent's Appendix A15-A22); *Osram Sylvania, Inc. v. Pennsylvania*, 863 A.2d 1140 (Pa. 2004), *aff'g* No. 310 F&R 1998 (Pa. Commw. Mar. 6, 2003) (Respondent's Appendix A23-A30).

If, instead, the transaction is analyzed in accordance with its *actual*, corporate law form and substance -- the actual sale of ABB C-E Nuclear's stock by Asea Brown

Boveri, Inc. -- then there is no transfer attributable to ABB C-E Nuclear which can be subject to Missouri tax and thus no gain to characterize as either business or nonbusiness income. Accordingly, the gain should be removed from ABB C-E Nuclear's tax base either as income which is unrelated to ABB C-E Nuclear's activities conducted in Missouri or by special apportionment. *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992); *Miller Bros. v. Maryland*, 347 U.S. 340 (1954).

III. If The Transaction Is Viewed In Accordance With Its *Deemed* Treatment Under IRC Section 338(h)(10) As The Deemed Sale Of ABB C-E Nuclear's Assets Followed By The Deemed Liquidation Of ABB C-E Nuclear, Then The Gain Constitutes Nonbusiness Income.

Although we are not aware of any Missouri case law directly on point, most states with functionally identical statutes have interpreted the "business income" definition as having two alternative tests, a "transactional test" and a "functional test." If an item of income does not qualify under the narrow and specific definition of "business income" under either the transactional test or the functional test, then that item of income will constitute "nonbusiness income."

While the Director expends much time and energy in elucidating the differences between the transactional and functional tests for determining business income, such an extensive exercise is unnecessary in this case as the gain at issue satisfies neither the transactional test nor the functional test. Therefore, the gain necessarily constitutes nonbusiness income under the Multistate Tax Compact.

A. The Gain Is Not Business Income Under the Transactional Test

A gain is classified as business income under the transactional test if it is derived from transactions in which the taxpayer *regularly* engages. Under the transactional test income arising from extraordinary or unusual events will *not* give rise to business income. *See, e.g., Lenox, Inc. v. Tolson*, 548 S.E.2d 513, 516 (N.C. 2001); *Laurel Pipe Line Co. v. Pennsylvania*, 642 A.2d 472, 474-75 (Pa. 1994).

In the present case, it cannot be disputed that the gain from the deemed sale of all of ABB C-E Nuclear's assets followed by the deemed liquidation of ABB C-E Nuclear and the deemed distribution of all of the sales proceeds to its parent is an extraordinary and unusual transaction. ABB C-E Nuclear was not engaged in the business of selling all of its assets. Indeed, at no time prior to April 28, 2000 or as a result of the transaction at issue, did ABB C-E Nuclear ever actually sell or otherwise dispose of all of its assets in Missouri or elsewhere. (Aff. ¶ 36.)

The absence of any transactions similar to the sale at issue herein establishes that the sale was not in connection with ABB C-E Nuclear's regular business.

Accordingly, given that the deemed sale of all of ABB C-E Nuclear's assets was not a transaction in the "regular course" of ABB C-E Nuclear's business, the gain is not business income under the transactional test. *E.g., Canteen Corp. v. Pennsylvania*, 818 A.2d 594, 599 (Pa. Commw. 2003) (gain from an IRC Section 338(h)(10) election does not constitute business income under the transactional test since "the fictional liquidation of assets stemming from the parent corporation's Section 338 election is not a

type of transaction in which Canteen regularly engages”) (Respondent’s Appendix A19), *aff’d*, 854 A.2d 440 (Pa. 2004); *May Dep’t Stores Co. v. Indiana Dep’t of State Revenue*, 749 N.E.2d 651 (Ind. T.C. 2001) (gain from sale of an entire division did not constitute business income under the transactional test because selling an entire division was not a regular business practice of the corporation); *Ex parte Uniroyal Tire Co.*, 779 So. 2d 227, 237 (Ala. 2000) (the complete liquidation of Uniroyal’s business through the sale of its partnership interest did not yield business income under the transactional test because the company “was not in business to go out of business”).

B. The Gain Is Not Business Income Under the Functional Test

Under the “functional test,” income constitutes business income only “if the acquisition, management, *and disposition* of the property *constitute integral parts of the taxpayer’s regular trade or business operations.*” Section 32.200, Art. IV.1(1) (emphasis added).

In *James v. International Telephone & Telegraph Corp.*, 654 S.W.2d 865 (Mo. banc 1983), the gain recognized by a taxpayer corporation from the divestiture of four subsidiaries pursuant to a consent decree was found to constitute nonbusiness income. In so holding, this Court agreed with the State Tax Commission and the circuit court that the taxpayer corporation was not in the business of buying and selling subsidiaries. *Id.* at 868. Similarly, the record in this instance clearly establishes that ABB C-E Nuclear was not in the business of buying and selling subsidiaries nor in the business of buying and

selling all of its assets; there was not even a sale of part of the company, but a complete sale of the entire business.

In *American States Insurance Co. v. Hamer*, 816 N.E.2d 659, 664 (Ill. App. Ct. 2004), *appeal denied*, 829 N.E.2d 786 (Ill. 2005), the issue was whether the gain from a deemed sale of assets from an IRC Section 338(h)(10) election constituted business income under the functional test (the Illinois Department of Revenue did not claim that the gain constituted business income under the transactional test) (Respondent's Appendix A10). In affirming the trial court's finding that the gain constituted nonbusiness income under a statute that is virtually identical to the Multistate Tax Compact adopted by Missouri, the court stated:

In sum, the trial court correctly applied the applicable case law. Moreover, the applicable case law is in accord with the growing consensus of opinion on the issue. The transaction at issue must be treated legally as a complete liquidation and cessation of business by the "old" American States. Indeed, even as a purely factual matter, the transaction involved the cessation of a separate and distinct portion of the business of the former shareholders of American States. Accordingly, the trial court properly ruled that *the gain at issue was nonbusiness income*.

816 N.E.2d at 667-68 (emphasis added) (Respondent's Appendix A13). *Accord Blessing/White, Inc. v. Zehnder*, 768 N.E.2d 332 (Ill. App. Ct.) (gain from the sale of

substantially all of a corporation's assets that had previously been used in its business constituted nonbusiness income where the corporation ceased its operations and distributed the sale proceeds to its shareholders), *appeal denied*, 786 N.E.2d 180 (Ill. 2002).

Similarly, the Pennsylvania Supreme Court affirmed decisions of the Pennsylvania Commonwealth Court and held that the gain from a deemed sale of assets from an IRC Section 338(h)(10) election constitutes nonbusiness income under a statute that is identical to the Multistate Tax Compact adopted by Missouri. *Canteen Corp. v. Pennsylvania*, 854 A.2d 440 (Pa. 2004), *aff'g* 818 A.2d 594 (Pa. Commw. 2003) (Respondent's Appendix A15-A22); *Osram Sylvania, Inc. v. Pennsylvania*, 863 A.2d 1140 (Pa. 2004), *aff'g* No. 310 F&R 1998 (Pa. Commw. Mar. 6, 2003) (Respondent's Appendix A23-A30).

In determining that the gain constituted nonbusiness income, the Commonwealth Court, *en banc*, found that:

The panel misapplied *Laurel Pipe Line* to reach a result that is inconsistent with the definition of "business income" in our corporate income tax statute and that ignores the Section 338(h)(10) election while still employing the fiction such an election creates to tax the fictional income. *If we ignore the fiction arising under the Section 338(h)(10) election, Canteen has no gain from the transaction and, if we embrace the election, Canteen is deemed to have sold all of*

its assets in a complete liquidation, which results in non-business income.

Canteen Corp., 818 A.2d at 599 (emphasis added) (Respondent’s Appendix A19-A20).

In *Laurel Pipe Line*, the Pennsylvania Supreme Court made clear that the gain resulting from the sale of a corporation’s assets in liquidation of the corporation’s business constitutes nonbusiness income even though the assets that were sold may have generated business income prior to the sale. *Laurel Pipe Line*, 642 A.2d at 475 (“the effect of the sale was that the company liquidated a portion of its assets. This is evidenced by the fact that the proceeds of the sale were not reinvested back into the operations of the business, but were distributed entirely to the stockholders of the corporation.”).

The Director misinterprets the holding of *Laurel Pipe Line*. The Director states that that case held that income will always meet the functional test if the assets sold produced business income while they were owned by the taxpayer. Br. at 33. However, as discussed above, that case actually held that the gain from the liquidation of a business will not produce business income under the functional test even if the assets sold produced business income while they were used in the business.

The Director also misreads the Multistate Tax Compact business income statute. The Director states that the inquiry under the functional test, as found in the second clause of the business income definition, is whether the property or assets were integral parts of the taxpayer’s regular trade or business. Br. at 33. However, a plain reading of the Multistate Tax Compact indicates the inquiry is actually whether the “acquisition,

management and disposition” of the assets were integral parts of the taxpayer’s regular trade or business. Hence, the result in *Laurel Pipe Line* where the disposition of the assets in a liquidation transaction was found to produce non-business income under the functional test even though the assets had been used to produce business income.

C. The Director’s Attempts To Distinguish The Cases Of Sister States Fail

The Director’s unsuccessful attempt to distinguish the decisions of sister states, Br. at 33-37, is based upon two misconceptions. First, the Director tries to distinguish the cases based on her theory that the entire corporate family, rather than the statutorily mandated taxpayer, should be considered in determining whether a gain constitutes business income or nonbusiness income. As was previously demonstrated, this theory is inconsistent with the Multistate Tax Compact and the Director’s own regulations.

Second, the Director attempts to distinguish the cases based on the distribution of the proceeds from the sale. Specifically, the Director asserts: “The distribution of proceeds to shareholders demonstrates that a sale is truly a cessation of business, rather than merely a refocusing. Such a demonstration is a key element not just in *Lenox*, but in other cases the AHC cites.” Br. at 36. The Director then asserts that these cases, including *American States Insurance Co. v. Hamer*, 816 N.E.2d 659 (Ill. App. Ct. 2004), *appeal denied*, 829 N.E.2d 786 (Ill. 2005), are therefore distinguishable from the instant case. Br. at 36-37.

What the Director fails to realize is that the IRC Section 338(h)(10) election considered in *American States* is the same election that took place herein. In both cases,

the stock of a corporation was sold and an IRC Section 338(h)(10) election was made. The effect of both elections was that the subsidiary (in this case, ABB C-E Nuclear) was deemed: (1) to have sold all of its assets in a single transaction to a new corporation; (2) to have received the proceeds from the sale; and (3) to have distributed such proceeds in a complete liquidation to its then parent corporation (*i.e.*, a liquidating distribution to its sole and only shareholder).

There is simply no basis in law for the Director to accept that the subsidiary in *American States* distributed the proceeds from the deemed asset sale to its parent corporation and not to accept that ABB C-E Nuclear is also considered to have similarly distributed the proceeds from its deemed asset sale to its parent corporation.

Accordingly, ABB C-E Nuclear's gain, just as the gain in *American States*, is nonbusiness income and the Director's attempt to distinguish the cases of sister states fails.

D. The Gain Constitutes Nonbusiness Income

As the foregoing establishes, if the federal income tax *deemed* treatment of the transaction under IRC Section 338(h)(10) controls the outcome (*i.e.*, the transaction is viewed as a deemed sale by ABB C-E Nuclear of all of its assets followed by the deemed distribution of the sales proceeds in a complete liquidation of ABB C-E Nuclear), then the resulting gain does not constitute business income under the transactional test because the deemed sale of all of ABB C-E Nuclear's assets was not a transaction in the "regular course" of ABB C-E Nuclear's business, and does not constitute business income under

the functional test because it arises from the complete liquidation of an entire business. Section 32.200, Art. IV.1(1). Consequently, the gain constitutes nonbusiness income. Section 32.200, Art. IV.1(5).

IV. If The Transaction Is Viewed In Accordance With Its *Actual*, Corporate Law Form And Substance -- As The Sale Of ABB C-E Nuclear's Stock By Its Parent Corporation -- Then The Gain Arises From Activities Lacking A "Definite Link" Or "Minimum Connection" With Missouri

In its Order Granting Summary Determination In Part, the Commission determined that the transaction at issue should be accorded IRC Section 338(h)(10) treatment under both federal law and Missouri law. Accordingly, the Commission did not reach ABB C-E Nuclear's argument that if, instead, the transaction is viewed in accordance with its *actual*, corporate law form and substance, then the U.S. Constitution prohibits the Director from taxing the gain. Appellant's Appendix A14 n.6.

A. The Director Cannot Tax Income Arising from Activities

Lacking a "Definite Link" or "Minimum Connection" with Missouri

A cornerstone of state taxation of multistate businesses is that a "State may not tax a nondomiciliary corporation's income . . . , if it is 'derive[d] from "unrelated business activity"' which constitutes a 'discrete business enterprise.'" *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 773 (1992) (quoting *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 224 (1980)). This principle rests on the settled rule that

there must be “some definite link, some minimum connection” between a state and the activity it seeks to tax. *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954).

The underlying rationale for this proposition is that the exercise of a state’s taxing power over a taxpayer’s activities is justified by the “protection, opportunities and benefits” the state confers upon such activities. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). If the state lacks a “definite link” or “minimum connection” with the activities in question, it has not “given anything for which it can ask return.” *Id.*

B. The Absence of a “Definite Link” or “Minimum Connection”

Between the Transaction Which Triggered The Gain and

Missouri Prevents The Director from Taxing the Gain

The facts demonstrate that Missouri has no relationship to the sale of the stock of ABB C-E Nuclear that would justify the Director’s taxation of any gain arising from that sale. At the time of the sale, Asea Brown Boveri, Inc. (the seller of the stock) was headquartered and commercially domiciled in Connecticut. The corporation did not conduct any business in Missouri, did not have any operations in Missouri, did not have any employees in Missouri, did not have any property in Missouri nor otherwise conduct any activities in Missouri. As a result, Asea Brown Boveri, Inc. did not, and was not required to, file Corporation Income Tax returns with or pay Corporation Income Taxes to Missouri and was not even a party to the present matter.

Moreover, all of the proceeds from the sale of ABB C-E Nuclear’s stock were received by Asea Brown Boveri, Inc. Finally, the sale of ABB C-E Nuclear’s stock “was

not negotiated in Missouri, did not close in Missouri nor otherwise involve any Missouri activity.” (Aff. ¶ 28.)

In summary, the *actual*, corporate law form and substance of the transaction which triggered the gain involved the sale of stock by a corporation that had no connection with Missouri. None of the activities regarding the sale involved Missouri. Missouri offered nothing with respect to this transaction for which it might ask a return. The gain is, therefore, unrelated to Missouri, and should be excluded in determining ABB C-E Nuclear’s Corporation Income Tax liability.

Therefore, if the transaction is viewed in accordance with its *actual*, corporate law form and substance -- as the sale of ABB C-E Nuclear’s stock by its parent corporation -- then the Due Process and Commerce Clauses of the U.S. Constitution prohibit the Director from taxing the gain because it arises from activities lacking a “definite link” or “minimum connection” with Missouri. *E.g., Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992); *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954). In such a case, the gain should be removed from taxable income either as income which was unrelated to ABB C-E Nuclear’s business activities conducted in Missouri, or by special apportionment.

CONCLUSION

For the foregoing reasons, the Commission's Order Granting Summary Determination In Part, dated June 23, 2005, and the Commission's Order, dated July 19, 2005, should be affirmed. Accordingly, the gain at issue should be found to constitute nonbusiness income or to otherwise not be includable in ABB C-E Nuclear's apportionable business income, ABB C-E Nuclear's Corporation Income Tax liability for its year ended April 28, 2000 should be found to be \$0, and judgment should be entered in favor of ABB C-E Nuclear in the amount of \$15,766.00, plus statutory interest due on the overpayment of tax paid to Missouri.

Dated: September __, 2006

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing was served by first class mail, postage prepaid, or hand-delivered this ____ day of September, 2006, to James Layton, State Solicitor General, P.O. Box 899, Jefferson City, Missouri 65102, Attorney for Defendant.

CERTIFICATE OF COMPLIANCE

The undersigned hereby certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b), and that the brief contains ____ words.

The undersigned further certifies that the labeled disk simultaneously filed with the hard copies of the brief has been scanned for viruses and is virus-free.

**IN THE
SUPREME COURT OF MISSOURI**

SC87811

ABB C-E NUCLEAR POWER, INC.,

Respondent,

v.

DIRECTOR OF REVENUE,

Appellant.

**On Petition for Review from the
Missouri Administrative Hearing Commission
Hon. Karen A. Winn, Commissioner**

APPENDIX OF RESPONDENT

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